In The

# Supreme Court of the United States



October Term, 1973

No. 72-1490

Federal Power Commission,
*Petitioner*,

v.

Texaco Inc., et al.,
*Respondents*.

No. 72-1491

Dudley T. Dougherty, et al., Co-Executors of the Estate of Mrs. James R. Dougherty, et al.,
*Petitioners*,

v.

Texaco Inc., et al.,
*Respondents*.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

## BRIEF OF THE SMALL PRODUCERS GROUP AS AMICUS CURIAE

J. Evans Attwell
Lynn R. Coleman
*Attorneys for Amicus Curiae, Small Producers Group*

*Of Counsel:*
William Pannill
Vinson, Elkins, Searls, Connally & Smith
2100 First City National Bank Building
Houston, Texas 77002

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]
[illegible]
[illegible]

[illegible]

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

---

No. 72-1490

FEDERAL POWER COMMISSION,

*Petitioner,*

v.

TEXACO INC., ET AL.,

*Respondents.*

---

No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL.,

*Petitioners,*

v.

TEXACO INC., ET AL.,

*Respondents.*

---

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

---

## MOTION OF THE SMALL PRODUCERS GROUP FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

---

The Small Producers Group, which is composed of a number of independent producers of natural gas holding Small-Producer Certificates of Public Convenience and Necessity and thus regulated pursuant to the terms of the Federal Power Commission's Order No. 428, respectfully moves under Paragraph 3 of Rule 42 of this Court for leave to file a brief as *amicus curiae* in support of the position of petitioners in this cause. The Group has been unable to obtain the consent of all the parties to this cause because it lacked adequate time to contact the many parties

to the litigation after the decision to prepare and file a brief was reached.

The Solicitor General indicated in the Government's petition to this Court for a writ of certiorari in the instant case that he considered the principal question of statutory interpretation before the Court to be that of the Commission's authority under Section 16 of the Natural Gas Act, 15 U.S.C. § 717o. We take a somewhat different view of the case. We believe this case raises the question of the scope of the Federal Power Commission's discretion to adopt varying methods of regulation under the Natural Gas Act, and can only be resolved by looking to the fundamental purposes of the Act as a whole. The decision could touch on a host of other cases arising from administrative actions the Commission has taken to construct a workable system of regulation in the midst of a natural gas shortage. Thus every gas producer and every gas consumer in the nation could be affected by the Court's decision in this case. In a case of such significance, the Group believes it appropriate that it be allowed to state an independent position.

WHEREFORE the Small Producers Association prays that this motion be granted.

Respectfully submitted,

J. Evans Attwell
Lynn R. Coleman
*Attorneys for Amicus Curiae,*
*Small Producers Group*

*Of Counsel:*
William Pannill
*Vinson, Elkins, Searls, Connally & Smith*
2100 First City National Bank Building
Houston, Texas

**Brief of the Small Producers Group as Amicus Curiae**

# INDEX



## CITATIONS

### Cases

## Miscellaneous

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

---

No. 72-1490

FEDERAL POWER COMMISSION,

*Petitioner,*

v.

TEXACO INC., ET AL.,

*Respondents.*

---

No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL.,

*Petitioners,*

v.

TEXACO INC., ET AL.,

*Respondents.*

---

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

---

## BRIEF OF THE SMALL PRODUCERS GROUP AS AMICUS CURIAE

---

## OPINIONS BELOW AND JURISDICTION

Amicus adopts petitioner's statements of the opinions below and jurisdiction.

## QUESTION PRESENTED

As one step in its efforts to deal with the critical natural gas shortage facing the nation, the Federal Power Commission has attempted to stimulate exploratory drilling by small producers, who have historically drilled 80 percent of all new wildcat wells, by regulating interstate sales of natural gas by small producers in a manner different from the area rate method used to regulate interstate gas sales by large producers. The question presented by the petitions is:

> Whether the Natural Gas Act permits the Federal Power Commission to prescribe a system of regulation for small producers of natural gas that differs from that applied to large producers.

## STATEMENT OF THE CASE

Amicus adopts petitioner's statement of the case.

## INTEREST OF AMICUS CURIAE

To regulate small producers by use of the same system of regulation as is applied to large producers will cause substantial harm to the economic interests of each member of the Amicus association, and by depressing the supply of natural gas, will adversely affect the national economy. Following this Court's decision in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 (1954), small independent producers, who number in the thousands, were subjected to the same thoroughgoing certificate and rate regulatory methods as major producers. Hence if a small producer drilled (or as is often the case, had a small interest in) a successful gas well, and wished to sell to an FPC-regulated pipeline, he had to retain counsel, file a certificate application with the Commission and wait, frequently for many months, before he could commence selling gas and receiving revenue.

To collect contractually authorized periodic price increases, he had to make a rate increase filing under Section 4(e) of the Natural Gas Act. Even though the annual increase might only be a few hundred dollars, he generally would be forbidden to collect it for six months (thirty days' notice plus a five-month suspension period) and then only subject to refund down to some "just and reasonable" price to be determined subsequently. In many cases, the subsequent determination was not made for years; some of them have not been made yet. The increase received by the small producer could not be plowed back into wildcat drilling because the small producer and his investor partners did not know whether they would have to make refunds. Finally, the maze of certificate, rate increase, refund, in-line, guideline, area rate and other producer litigation that spread through the 1960's was unfathomable to the small producer, who lacked the staff or financial wherewithal to participate in the protracted proceedings before the Commision. But the consequences to the small producer of such litigation were the same to him as to major companies having dozens of lawyers assigned full-time to keeping up with such developments.

Capital formation for small producer wildcat drilling ventures is difficult at best. Banks rarely loan money for this purpose since the risk of non-success is high. Private investors, many of whom are not oil men, are a primary source of capital. To a small producer trying to put a drilling deal together and his potential investors, the regulatory hassle facing him in Washington, if he were lucky enough to discover gas, was viewed as nothing short of nightmarish. If he found gas, the temptation was enormous to dispose of it to a non-jurisdictional intrastate buyer. Many small producers came to the conclusion that it wasn't worth the effort and, as statistics confirm, went into other businesses.

In 1960 there were 18,000 active small producers, but their number had dwindled to 4,000 by 1971. Interstate reserve dedications declined precipitously and, as the Commission found, the public interest was ill-served by the decimation of the small producer ranks.

Yet expanded drilling activity by small producers is of vital public importance. Although small producers are responsible for only 10 per cent of the gas in pipelines, Pet. App. 32a, the Commission found in its rulemaking proceeding that the exploratory efforts of small producers are vital to expanded gas production, Pet. App. 31a, and the Court of Appeals agreed that small producers "have historically accounted for as much as 80 per cent of new exploration, but have less ready access to the necessary capital than do large producers . . . ." Pet. App. 6a. The Commission also found that previous efforts at relief have been inadequate, particularly when small producers have had to seek the same regulatory treatment as large producers. *Exemption of Small Producers From Regulation, Notice of Proposed Rulemaking,* FPC Dkt. No. R-393, 35 Fed. Reg. 12220 (1970). The Commission found, and the Court of Appeals agreed, that the quantum of regulation that small producers have undergone has discouraged their exploration activity and that their realization of full contract prices for sales of gas would assure them of stable revenue sources which could be used in expanding exploration activity. In the Order under review, the Commission conceived its basic consumer protection function under the Natural Gas Act to be twofold: to encourage development and commitment of gas supplies and to protect the consumer against unreasonable prices. Believing that the public is poorly served by technically correct, lengthily adjudicated prices for non-existent gas, the Commission, within the ambit of its discretion, lawfully fashioned a

different regulatory framework for small producers that is consistent with its twofold objective.

## SUMMARY OF ARGUMENT

The issued presented in this case is whether the Commission has the power under the Natural Gas Act to create a simplified regulatory system for interstate sales of gas by small producers that relies on monitoring of contract prices that interstate pipelines agree to pay small producers. The statute does not prohibit a method of regulation such as the one the Commission adopted, and the decisions of this Court have made it plain that the Commission can adopt any method or variety of methods to regulate gas producers that fits the purposes of the Act and produces satisfactory end results. The extensive system of price monitoring the Commission has adopted will serve those purposes by guarding against excessive prices while at the same time eliciting a greater supply of natural gas. For these reasons, the Court below erred in substituting its judgment for the Commission's. The Order under attack should be sustained by this Court as a valid exercise of the Commission's discretion, and the Court should reaffirm the Commission's flexible power to regulate interstate sales of natural gas by producers.

## ARGUMENT

**(1) Section 4(a) of the Natural Gas Act should not be construed to forbid the Commission to adopt indirect price supervision of small producers.**

The fundamental issue before the Court is whether Congress has given the Commission the discretion to create a method of regulation for small producers that differs from that for large producers.

The Natural Gas Act commands only that the prices producers charge "shall be just and reasonable". § 4(a), 15 U.S.C. § 717c(a), Pet. App. G at 85a. It does not provide, by its terms, that the Commission must subject all producers' prices to direct and detailed government regulation to produce rates that are just and reasonable,[1] as the Court of Appeals has erroneously held. *Texaco Inc.* v. *FPC*, — F.2d — (D.C. Cir. No. 71-1560, Dec. 12, 1972), Pet. App. 3a-22a.

The statute does not in terms fix any method of regulation and this Court has never held that the statute requires any particular method—by ceiling prices, cost-of-service calculation, or other schemes—to ensure just and reasonable prices. ***Permian Basin Area Rate Cases,*** 390 U.S. 747, 776-77 (1968). Nor does the case of ***Phillips Petroleum Co.*** v. ***Wisconsin,*** 347 U.S. 672 (1954), necessarily impose on the Commission more than a duty to ensure that rates are just and reasonable, rather than a duty of direct utility-type regulation of price.[2] Nor does the *Catco* case, ***Atlantic Refining Company*** v. ***Public Service Commission of New York,*** 360 U.S. 378 (1959), insist on any method of regulation; it

---

[1] The Commission did, in fact, impose direct regulation on several aspects of small-producers' prices. *See* page 15 *infra*.

[2] The Court alluded to the Commission's power over prices in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), but it did not purport to define how the regulation was to be implemented. It said:

> The Power Commission is *authorized* by § 4 of the Natural Gas Act to regulate the "rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission . . ." *Id.* at 676 (emphasis added).

The Court went on to say that the producers' "sales in interstate commerce of natural gas for resale are *subject to* the jurisdiction of and regulation by the Federal Power Commission." *Id.* at 676 (emphasis added).

only holds that the Commission has the duty to ensure that initial gas rates are in "the public interest." *Id.* at 392.

The Court of Appeals for the Fifth Circuit has interpreted the Natural Gas Act to allow action like that the Commission took in Order No. 428. In the *Southern Louisiana Area Rate Cases,* the Fifth Circuit said:

> The decisions of the Supreme Court definitely indicate that the Commission has a responsibility to take the steps necessary to assure that wellhead prices are in the public interest. The Commission does not have to employ the area rate method, or for that matter regulate price directly at all, but it has chosen to fulfil its duty in that manner here.

*Austral Oil Co.* v. *FPC,* 428 F.2d 407, 415 n.9 (5th Cir.), *cert. denied,* 400 U.S. 950 (1970)

The Fifth Circuit has correctly construed the Act,[3] because this Court, in examining the purposes of the Natural Gas Act, has held that the statute's language must be interpreted to allow the Commission the utmost flexibility and discretion in fashioning effective methods of producer regulation.

> This Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred . . . . Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.

*Permian Basin Area Rate Cases,* 390 U.S. at 776.

---

[3] This interpretation of the Act is supported in Breyer & MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers,* 86 HARV. L. REV. 941, 986-87 (1973) [hereinafter cited as *Breyer & MacAvoy*]. These authorities conclude that "[n]othing in the *Phillips Petroleum* decision *requires* the FPC to set prices . . . ," and thus that the FPC has the power to practice "selective rather than pervasive interference with field market transactions." *Id.*

The principal purpose of the Natural Gas Act was to ensure that consumers receive the supplies of natural gas they need at reasonable prices, by "balanc[ing] . . . the investor and the consumer interests." *Id.* In this balancing process, price is a neutral element. The specific evil Congress sought to remedy in enacting the legislation was *excessive* prices charged by gas companies with monoply power to raise prices at will. Thus the immediate purpose of the statute was "[p]rotection of consumers against exploitation at the hands of natural-gas companies . . . ." *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672, 685 (1954). It follows that the Commission has the power under the statute to adjust the method and intensity of its regulation to the power of natural-gas companies to exploit consumers. Here the Commission has determined that small producers lack the power to exploit consumers,[4] and it has decided on an experimental program of indirect price regulation to create for small producers the incentive to expand their efforts in exploration and development by freeing them of many of the administrative and price aspects of regulation that have choked off their production under the area rate ceilings.[5]

The Court below held that small-producers' prices could not be exempted from the regulatory scheme, which it took to be the area rates the Commission has found to be "just and reasonable," because regulation that failed to set price levels would be "outside the present language of the Act." Pet. App. 17a. But the test of whether a price is just and reasonable is not whether it conforms to the area-rate method of price-setting, or whether a Government agency sets it all, but whether it produces results that are in accord with the purposes of the Act. *Compare Atlantic Refining Company*

---

[4] *See* page 19 *infra.*
[5] *See Breyer & MacAvoy* at 958-962.

v. *Public Service Commission*, 360 U.S. 378, 390-92 (1959), *with United Gas Pipeline Company* v. *Mobile Gas Service Corporation*, 350 U.S. 332 (1956). There is no magic number that the Commission must uncover before there can be a just and reasonable price. In fact, there is no definition of a just and reasonable price in the Act at all; it is only a price that "is necessary in the public interest." Natural Gas Act, § 1(a), 15 U.S.C. § 717(a).

Thus, as Mr. Justice Jackson wrote in his celebrated concurring opinion in the *Colorado Interstate* case, price is "a tool to bring goods to market—to obtain for the public service the needed amount of gas." *Colorado Interstate Gas Company* v. *FPC*, 324 U.S. 581, 612 (1945) (concurring opinion). The only just and reasonable price is one that produces the needed amount of gas without concomitant exploitation of consumers. It follows that the prices paid to small producers can be wholly different from large-producer prices and set by altogether different standards and remain just and reasonable if they serve the purposes of the statute. This Court has held that the Commission has the power under the just and reasonable standard of the Act to

> employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price for future programs of exploration and production.

*Permian Basin Area Rate Cases*, 390 U.S. at 797.

In the *Permian Basin* case, the Court had before it a Commission order that provided for a two-price system of ceiling rates, based on the date of discovery of the well. The purpose of this system was to provide a higher price as an incentive for the discovery of new gas, while holding the price of old gas already discovered to the levels of average

historical cost. This was attacked as producing an anomalous situation in which two producers, side by side, could receive two different "just and reasonable" prices for gas of identical quality and Btu content. But the Court held that the statute sanctions different prices for different sales.

> We hold that the stautory "just and reasonable" standard permits the Commission to require differences in price for simultaneous sales of gas of identical quality, if it has permissibly found that such differences will effectively serve the regulatory purposes contemplated by Congress.

*Id.* at 797-98.

Thus Order No. 428 is fully consonant with the Court's broad construction of the Act. It offers an incentive to exploration but guards against excess prices. Price is being used here for exactly the same purpose as the two-price system was used in the *Permian Basin* case, and the Court has made clear that it is not how the price is arrived at but what it results in that determines whether it squares with the statute.

**(2) The Federal Power Commission has been granted broad discretion and flexibility to fashion effective methods of regulation under the Natural Gas Act; and the Court of Appeals erred in substituting its judgment for the Commission's.**

The Commission has been held to have a "legislative discretion" in the process of regulating natural gas prices that embraces "the method used in reaching the legislative determination as well as the determination itself." *Permian Basin Area Rate Cases*, 390 U.S. at 776; *Los Angeles County Gas Company* v. *Railroad Commission*, 289 U.S. 287, 304 (1933). When the Commission determines that effective regulation requires the adoption of new methods,

this Court should not set aside that determination unless it bears no rational relationship to the just and reasonable standard of the Act.

This Court has held that the determination at issue here is of the type that has been entrusted to the expert judgment of the Commission, so long as the end result accords with the statute:

> [W]e have heretofore emphasized that Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not to the preferences of reviewing courts. A presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *FPC* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602. We are not obliged to examine each detail of the Commission's decision; if the "total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Ibid.*

Moreover, this Court has often acknowledged that the Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within the "zone of reasonableness." *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 585. No other rule would be consonant with the broad responsibilities given to the Commission by Congress; it must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests. It is on these premises that we proceed to assess the Commission's orders.

*Permian Basin Area Rate Cases*, 390 U.S. at 767.

The history of regulation under the statute shows that this Court has consistently interpreted the Natural Gas Act as laying down no formula and prescribing no method for the supervision of natural gas prices. This Court has recognized that the Commission must make "pragmatic adjustments," *FPC* v. *Hope Natural Gas Company*, 320 U.S. 591, 602 (1944), and that it must not be bound to "any artificial rule or formula." *Los Angeles Gas Company* v. *Railroad Commission*, 289 U.S. at 305. This broad discretion is to allow the Commission to adapt to changed circumstances with new methods consistent with the purposes of the regulatory power. *Id.*; *see American Trucking Associations* v. *United States*, 344 U.S. 298 (1953); *National Broadcasting Company* v. *United States*, 319 U.S. 190 (1943).

The history of regulation of natural gas producers under this Act demonstrates that the Commission is free to adjust its methods of regulation when they prove ineffective. The Commission began to regulate producers by determining their costs of service, but when it concluded that that method was neither "workable or desirable," the Court allowed it to abandon proceedings in progress that relied on that method and to adopt the area-rate method of ceiling price regulation. *Wisconsin* v. *FPC*, 373 U.S. 294, 299, 314 (1963). The Court, noting the "unique problems" confronting the Commission, *id.* at 296, considered the argument that the cost-of service method was the only lawful method of regulation and said:

> [T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly

> articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method will be followed by the Commission in considering the justness and reasonableness of rates.

*Id.* at 309.

When the actual method of area rates was reviewed by the Court, it approved the Commission's order, at the same time making it clear that it expected many questions to be "more precisely and efficaciously" treated in the future, *Permian Basin Area Rate Cases*, 390 U.S. at 822, and warning the Commission that it needed to take "many steps toward a more expeditious and effective system of regulation," *id.* at 772 n.37. Nevertheless, the Court entrusted the method of regulation to be followed to the Commission's informed judgment. *Id.* at 776-77. Thus the Court has declined to instruct the Commission to follow any particular method for deciding what constitutes just and reasonable prices that the Commission must follow.

In fact, not only has the Court made it clear that it expects the Commission to make its own determinations, the *Permian Basin* case specifically instructs the Commission to continue to re-evaluate its methods in the light of these same "unique problems" it faces and the goal it seeks to reach. This case represents another modification in the evolution of regulation of producers, and the Commission's method of small producer regulation should be upheld as just and reasonable, for the Order in question lies clearly within the Commission's special expertise.

**(3) Order No. 428 constitutes a valid exercise of the Commission's legislative discretion because it will ensure gas production at just and reasonable rates.**

The rulemaking that produced Order No. 428 was initiated after a clear instruction from this Court that the Commission was to heed warnings that area ceilings were likely to cut production by forcing higher-cost producers out of business. The Court said:

> We are cognizant, as presumably is the Commission, of the forceful argument that the computation of rates from costs is ultimately circular . . . We assume that the Commission will continue to examine both the premises of its regulatory methods and the consequences for the industry's future of its rate-making orders. Nothing under the Act or the cases of this Court compels the Commission to reduce its regulatory to self-fulfilling prophecies.

390 U.S. at 816 n.99. *See Breyer & MacAvoy* at 961-62 & n.79.

The Commission's Order was issued on the basis of its expert judgment after a seven-month process of rulemaking that weighed comments from 73 parties. It was begun two years after the Court's instructions to ponder its methods of producer regulation in the *Permian Basin Area Rate Cases, supra.* The Commission gave great weight to indications that small-producer exploration activity, often carried on at higher costs than that of the major producers, was being curtailed because of ceiling-price regulation.[6] Faced with a spreading gas shortage, the Commission believed that action to remedy this situation was imperative, since small producers have accounted for as much as 80

[6] *See Southern Louisiana Area Rate Cases,* 428 F.2d 407, 442 & n.13 (5th Cir.), *cert. denied,* 400 U.S. 950 (1970); *Breyer & MacAvoy* at 961-62. *See* note 11 *infra.*

per cent of new exploration. Pet. App. 31a. Since the small producers account for only about 10 per cent of gas entering pipelines, the Commission believed that it was balancing consumer and producer interests, with consumers being provided important new sources of gas in return for de minimis price increases. Pet. App. 32a.

(a) *The Commission has devised an effective regulatory method for small producers.*

The Commission made it plain in Order No. 428 not only that it retains jurisdiction over small producers but also that it intends to monitor their sales closely to ensure just and reasonable prices.

> The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales. We shall also provide certain other safeguards against unreasonably high small producer prices, as hereinafter discussed, to assure adequate protection for the consumer.

Pet. App. 32a.

The other safeguards the Commission adopted consisted of direct regulation of several aspects of small-producer prices. It proscribed the use of certain contract provisions, above area ceiling prices. These included favored-nations, price - redetermination, and spiral - escalation provisions "that may have an adverse impact on consumers." Pet. App. 32a-33a; *see FPC* v. *Texaco Inc.,* 377 U.S. 33, 41 (1964). The Commission also regulated the sale by large producers to small producers of developed gas reserves by providing that they must have separate authorization. Pet. App. 33a.

The Commission announced it would scrutinize pipeline purchases from small producers by ordering the filing of all

contracts, and order pipeline and large-producer refunds where prices paid by them are "unreasonably high," that is to say, above market prices, which gives pipelines an incentive to bargain with small producers for a lower price. Pet. App. 37a-38a. The Commission noted that the market standard, which is based on comparison with the highest contract prices of intrastate producers or large producers in the area, would likely produce de minimis price increases. "[A]s a practical matter, the small producer is normally not in a position to obtain more for the sale of its gas than the large producer whose jurisdictional sales are subject to the ceilings prescribed by the Commission in each area. The impact on the consumer of exempting small producers from regulation should thus be minimal." *"Exemption of Small Producers From Regulation, Notice of Rulemaking,* FPC Dkt. No. R-393, 35 Fed. Reg. 12220 (1970). But the Commission still exacted a quid pro quo for the price relief thus dispensed. It provided that if a small producer finds new gas reserves and contracts to sell them in the interstate market, he must continue sales of his gas reserve to the interstate buyer until depletion or until abandonment authorization is obtained from the Commission under Section 7(b) of the Act. 15 U.S.C. § 717o(b). The practical effect of this requirement is that the small producer must continue to sell gas until his reserve is exhausted and cannot exceed his contract rate after expiration of the contract unless the Commission grants him permission. Pet. App. 36a n.4.

The Commission retains its statutory power of intervention in any gas-sales contract it finds, as a result of this monitoring, to be unjust or unreasonable. This power of intervention, in Section 5(a) of the statute, will allow the Commission to "order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise un-

lawful, or are not the lowest reasonable rates." § 5(a), 15 U.S.C. § 717d(a).

The Commission has thus erected an extensive system of market supervision and control for small producers, which includes price monitoring, proscription of certain practices as unjust and unreasonable, sanctions against pipelines to ensure hard bargaining, and the prospect of price roll-backs wherever the Commission finds that undue or excessive market power exists on the part of a producer. A number of experts have urged the use of methods like these to correct the failures of past methods of regulation;[7] even the Court of Appeals agreed that the Commission "appears to have made a powerful case." Pet. App. 18a. But the majority of the Court of Appeals nonetheless characterized the system as "non-regulation." Pet. App. 16a. The better view is expressed in the dissenting opinion of Judge Fahy:

> [T]he question is whether we can hold, on the record before us, that the type of regulation of prices adopted by the Commission has led or will lead inevitably to unjust or unreasonable rates charged by small producers to purchasers of gas from them . . . .
> . . . A higher rate than that previously fixed for the industry in the area may be just and reasonable for the small producer as a separate classification within the area. The Commission is attempting to learn whether under this program the small producers, relieved of much of the burden of regulation required of other

[7] C. HAWKINS, THE FIELD PRICE REGULATION OF NATURAL GAS 211-16 (1969); *see Breyer & MacAvoy* at 948, 985-86; Testimony of M. Adelman, *Hearings Pursuant to S. Res. 45 Before the Senate Comm. on Interior & Insular Affairs*, 92d Cong., 2d Sess. 54-55 (1972); Brown, *Introduction* to REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 12 (1970); Russell, *Producer Regulation for the 1970s* in *id.* 234.

classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable, and which will not adversely affect the consumer interests protected by the Act.

Pet. App. 19a-20a.

As Judge Fahy observes, no rates have been attacked as unjust or unreasonable under this Order. Pet. App. 21a. In fact, all three judges on the Court agreed that the Commission's experimental system for the regulation of small producers represents wise policy, and constitutes an exercise of the Commission's "diligence and expertise," Pet. App. 17a, to which this Court has always afforded decisive weight. *Permian Basin Area Rate Cases*, 390 U.S. at 767. Plainly the Commission's determinations, shaped by its regulatory experience and its expertise, constitute a complete system of regulation. Far from "abdicat[ing] its regulatory responsibility," Pet. App. 12a-13a, the Commission has fulfilled it with a carefully drawn and thoroughly considered plan for the price supervision of small producers.

(b) *The characteristics of the small producer segment of the producing industry permit effective regulation in this manner.*

The purpose of the Act is to balance the interests of consumer and producer while at the same time protecting the consumer against exploitation at the hands of natural-gas companies. Since it is axiomatic that small producers generally lack the monopoly power to charge consumers excessive prices for supplies of natural gas, ceiling-price regulation is not only unnecessary for them but harmful to the consumer's own best interest by depressing supply.[8] Here the Commission has based its judgment on its long

---

[8] *See Breyer & MacAvoy* at 948-49.

experience with natural gas producers. There are thousands of small producers of gas, and entry into the business is free.[9] In removing direct price ceilings for small producers, the Commission determined in Order No. 428 that there is little risk that they will charge the consumer excessive prices. "Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce." Pet. App. 31a. The Commission was acting against a background of ample evidence that attempts to regulate the naturally competitive segments of the natural gas producing industry with ceiling prices[10] have brought

---

[9] The Commission has pointed out that there were more than 18,000 producers in 1960, but the number had fallen to 4,000 by 1971. *Belco Petroleum Corp.*, — F.P.C. —, slip. op. 12-13 (May 30, 1973). *See also Permian Basin Area Rate Cases*, 390 U.S. at 784 n.49. Of these 4,000, about 85 are large producers selling more than 10 million Mcf of gas per year. *Order Establishing Hearing to Show Cause Why Uncommitted Gas Reserve Data Should Not be Produced in Nationwide Investigation*, FPC Dkt. No. R-405-A, 38 Fed. Reg. 29821, 29822 n.2 (Oct. 29, 1973).

One economist has found that after the largest producers are accounted for, the rest of the market is "relatively unconcentrated" and that "the barriers to entry for natural gas production are substantially less than in most manufacturing." Hawkins, *Structure of the Natural Gas Producing Industry* in REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 137, 141, 138 (1970).

[10] Indeed, the goal of regulation is to set monopoly prices at the same level as competitive prices. "The object of regulation is to achieve the results that free market competition produces in other industries . . ." J. McKIE, THE REGULATION OF NATURAL GAS 5 (1957).

on the gas shortage.[11] The effect of the Commission's determination in this situation is to improve the effectiveness of regulation by adopting the pricing method most likely to produce quickened gas exploration.

The Court of Appeals rejected this exercise of the Commission's informed judgment as "semantic." Pet. App. 14a. The majority said the Commission "ignores the essential difference between a regulated and an unregulated industry. Put simply, the latter is governed by the market while the former, by definition, is the subject of active governmental control". *Id.* But this Court has found that natural gas producers do not constitute a typical regulated industry because they do not possess the natural monopoly characteristic of virtually all other regulated industries. "[P]roducers of natural gas cannot usefully be classified as public utilities." *Permian Basin Area Cases,* 390 U.S. at 756; *see id.* n.11, 757.

Thus the Court of Appeals, spurning the Commission's expert judgment and failing to examine its premises, struck the order because it was evident that small producers' rates were to be exempt from "previously Commission-determined 'just and reasonable' rates." Pet. App. 14a. In so doing, the Court erred.

(c) *This method of regulation assures the consumer that he will benefit by obtaining additional supplies of natural gas at just and reasonable prices.*

---

[11] *Breyer & MacAvoy* at 976-79; MacAvoy, *Regulation-Induced Shortage of Natural Gas,* 14 J. LAW & ECON. 167, 168 (1971); *see* Brown, *Introduction,* REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 7, 11 (1970); Erickson & Spann, *Price, Regulation, and the Supply of Natural Gas in the United States, id.* at 214; Russell, *Producer Regulation for the 1970s, id.* at 228-29; *cf.* Kitch, *Regulation of the Field Market for Natural Gas by the Federal Power Commission,* 11 J. LAW & ECON. 243, 277-79 (1968).

Low prices alone are not the *sine qua non* of producer regulation, for price is not an end in itself but only a mechanism by which supply is brought forth. The United States contains between 1,178 and 2,100 trillion cubic feet of undeveloped natural gas. FPC BUREAU OF NATURAL GAS, NATURAL GAS SUPPLY AND DEMAND, 1971-1990, *Staff Report No.* 2, at 13 (FPC Pub. No. S-218, 1972). Yet current proved reserves fell by 10 per cent in the late 1960's and continue to drop now. The gas shortage has caused large numbers of consumers to be denied gas service at all, and has seriously affected economic growth. *Breyer & MacAvoy* at 980-84. The Commission itself has described the gas shortage as "devastating." *George Mitchel & Associates,* F.P.C. Op. No. 649, — F.P.C. — slip op. at 6 (Feb. 21, 1973). From 1971 to 1972, seven major pipelines were forced to curtail winter service, and the FPC staff, which has found deliveries fell short of consumption by 5.1 per cent in the winter of 1972, predicts they will fall short by 12.1 per cent in 1975. MacAvoy & Pindyck, *Alternative Regulatory Policies for Dealing with the Natural Gas Shortage,* BELL J. ECON. & MANAGEMENT SCIENCE 454, 455 (Autumn, 1973). For the year April 1972 to March 1973, curtailments of gas supplied by interstate pipelines was estimated to have reached one billion cubic feet. *Just and Reasonable National Rates for Future Sales of Natural Gas from Wells Commenced on or After January 1, 1973, Notice of Rulemaking,* FPC Dkt. No. R-389B — Fed. Reg. — (April 11, 1973). The FPC has estimated that the annual level of unsatisfied demand will increase from 3.6 trillion cubic feet in 1975 to 9.5 trillion cubic feet by 1980, with a further increase to 17.1 trillion cubic feet by 1990. FPC BUREAU OF NATURAL GAS, NATIONAL GAS SUPPLY AND DEMAND, *supra,* at 3.

To help ameliorate the shortage, the United States has been forced to import alternate fuels in the form of lique-

fied natural gas and higher priced Canadian supplies and to lay plans to produce gas from coal and naptha. Since all these expedients can be purchased only at prices double or triple the ceiling price of natural gas in the United States,[12] the domestic consumer will benefit directly by the expanded domestic supply that indirect regulation of small producers will bring.

The Commission has recognized that the consumers' real interest now coincides with that of the small producer. Thus the Commission has promulgated the Order based on its expert judgment that removal of "unwise and self-defeating limits" for small producers will help expand the natural gas supply at just and reasonable prices. The Commission has concluded that under the Natural Gas Act, that which is "economically wise" must be "legally permissible." *FPC v. Hope Natural Gas Company,* 320 U.S. 591, 652 (1944) (dissenting opinion). The Order should be sustained because it falls within the Commission's statutory power and its administrative discretion.

---

[12] Foster, *Projected Costs of Alternate Sources of Gas,* REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 63, 88 (1970); *Belco Petroleum Corporation, supra,* note 10, at 36-37.

## CONCLUSION

The Small Producers Group urges the Court to reverse the Court of Appeals and affirm Order No. 428 of the Federal Power Commission.

Respectfully submitted,
J. EVANS ATTWELL
LYNN R. COLEMAN
*Attorneys for*
*Amicus Curiae,*
*Small Producers Group*

*Of Counsel:*

WILLIAM PANNILL
VINSON, ELKINS, SEARLS,
CONNALLY & SMITH
2100 First City National
Bank Bldg.
Houston, Texas 77002